

Task Force for the Payments System Review

Policy Papers

An Overview

December 2011

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Policy Papers: An Overview

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Introduction

On June 18, 2010, the Minister of Finance, the Honourable Jim Flaherty, announced the creation of the Task Force for the Payments System Review.

Since then, the seven members of the Task Force have sought to understand the Canadian payments system, to find out how well it serves its users, and to determine what needs to be done for the future. Our mandate (see below) was to provide the Minister of Finance with actionable advice and recommendations to help ensure that the payments system continues to meet Canadian needs.

Mandate of the Task Force for the Payments System Review

Given the importance of a safe and efficient payments system and the need to ensure that the framework supporting the payments system remains effective in light of new participants and innovations, the government is appointing this task force to conduct a review of the payments system.

Specifically, the task force will:

- Identify public policy objectives to be pursued in the operation and regulation of the payments system;
- Identify and assess the regulatory and institutional structures best suited to achieving these public policy objectives;
- Assess and report on the safety and soundness of the Canadian payments system;
- Assess the competitive landscape by identifying any potential barriers for new entrants and mechanisms to improve the competitive landscape of the domestic payments system;
- Assess the degree of innovation in the domestic payments system and report on the challenges and opportunities to bring new and innovative products to market in Canada; and
- Assess and report on whether consumers and merchants are well served by the domestic payments system.

Through the above assessment, it is expected that the task force will provide concrete, actionable advice and recommendations to the Minister of Finance to help guide the evolution of the payments system in Canada.

The result of our work is presented in *Moving Canada into the Digital Age*. To provide policy background for the conclusions and recommendations expressed in that report, four policy papers were developed, reflecting in part the valuable contributions of the working and advisory groups. This document provides an overview of those policy papers and of four other publications of the Task Force—discussion papers that capture some of the dialogue and collaboration that led to the conclusions and recommendations in our final report.

Dialogue: Task Force approach

The payments system does not exist in isolation: it is connected in fundamental ways to the lives of all Canadians, to their institutions and to the economy. Given the importance of the system to Canadians, as well as the complexity, rapid change and resulting uncertainties of the payments environment, the Task Force decided to go beyond the usual analytical approach to such studies and to engage key stakeholders and industry experts in a genuine and sustained dialogue. In particular, we were determined to hear the points of view of the various users of the system, including consumers, businesses and governments.

In pursuing this approach, we used every tool at our disposal to reach out to the payments industry and to users of the system. Our efforts included two separate rounds of online consultations, a scenarios process, several working and advisory groups, national and regional roundtables, panel discussions, and hundreds of meetings, as well as dialogue via the social media.

The conclusions and recommendations in our final report respond to the overall request of the Minister of Finance for “concrete, actionable advice and recommendations . . . to help guide the evolution of the payments system in Canada,” “given the importance of a safe and efficient payments system and the need to ensure that the framework supporting the payments system remains effective in light of new participants and innovations.” The test of our success will be whether future actions by government and by those who provide and use Canada’s payment services lead to the creation of a reinvented payments system that is capable of meeting the evolving needs of users, as well as the new competitive challenges facing Canada in a digital age.

Although we have tried to anticipate the future, the truth is that no one can predict it. That is why ongoing participation and collaboration represent our best chance to define the goals, develop solutions and shape the future together.

Task Force papers

Discussion papers

Throughout its work, the Task Force and its advisory and working groups actively engaged in participatory dialogue and related research. This process played a key role in shaping our understanding of the payments system and informing our recommendations for its reform. As we went along, we sought to capture the essence of this work in four separate discussion papers.

Scenarios for the Future of the Canadian Payments System

Early in our mandate, with preliminary research under way and emergent principles in hand, we launched our major consultations with stakeholders.

Between September 2010 and February 2011, a group of leaders, including users, new entrants and incumbents, met to develop four plausible but distinct scenarios for the future of the Canadian payments system. Scenarios were framed by two critical dimensions of uncertainty regarding the future

of the Canadian payments system: 1) the degree of alignment of the payments ecosystem (aligned or fragmented), and 2) the extent of user adoption (rapid or moderate).

This exercise broadened our perspectives, showed us first-hand the advantages of collaboration and inspired us to continue the dialogue through the rest of our work.

The Way We Pay: Transforming the Canadian Payments System

Published in July 2011, *The Way We Pay: Transforming the Canadian Payments System* described the evolution of the Task Force's thinking to that point. It expanded on fundamental challenges facing the industry and articulated a set of principles that we have since developed and refined. It also set out the elements of a proposed governance framework that became central to our eventual recommendations.

The Way We Pay became the basis of our second round of online consultations in the summer of 2011. Comments and feedback on this work were invaluable in developing the actionable recommendations demanded by our mandate.

Going Digital: Transitioning to Digital Payments

In response to the critical momentum gained through the Scenarios Roundtable, the Task Force struck eight working and advisory groups, drawing on the strengths of over 250 professionals to work together on options for and on solutions to some of the most difficult challenges facing the industry.

Going Digital emerged as a report on the findings of three of these working groups: 1) Electronic Invoicing and Payments, to help move businesses and institutions away from paper-based payments; 2) Mobile Payments, to help Canadian consumers engage through their wireless devices; and 3) Digital Identification and Authentication, a new way of verifying the identity of people online.

The ideas in *Going Digital* are critical. They are inextricably linked to the broad policy dimensions of the payments system—governance, legislation, competition, innovation, infrastructure and the needs of users.

Credit and Debit Card Markets

Canadians are among the heaviest users of credit and debit cards in the world. These cards are widely used and accepted for retail payments, and their usage continues to grow. Stakeholders had a keen interest in the credit and debit cards markets. It was essential, therefore, that the Task Force focus special attention on them in its work.

In terms of the work of the Task Force as a whole, the *Credit and Debit Card Markets* study helped reinforce our conclusion that markets should be allowed to operate as flexibly as possible, provided that the participants can make informed choices and that there is effective oversight to protect the public interest. We also concluded that the Code of Conduct for the industry needs regular review and updating.

Policy papers

Toward the end of the Task Force review, we sought to crystallize our thinking in a series of four policy papers. In their final form, as now published, these came to be the chapters in a single story about how Canada's payments system should change. The story starts by looking at users' needs and at how they define the policy objectives for reform of the system. It continues by setting out a new principles-based governance model that would empower the participants in the system—users and providers, working together—to create the future of the industry. It then defines the legislative action needed to bring this about, and concludes by focusing on the changes that are required to provide the updated core infrastructure on which a new payments system will depend.

Policy Paper A: Users and their Discontent

The payments system exists to serve its users—consumers, merchants, small and medium enterprises, not-for-profit organizations, large corporations and governments. Policy Paper A first explores where the current system fails to meet their needs and expectations and some of the reasons for this failure. From this analysis, it proposes three simple principles to guide the future development of the payments system: *trust*, *access* and *good value*. These principles provide a foundation for the remaining papers.

Policy Paper B: Governance—Stakeholders and their Disconnect

To bring about change, the Task Force believes that a new governance model is required to protect the public interest and to enshrine the guiding principles. To cope with the rapid and discontinuous change occurring in the payments industry, this governance model must promote collaboration and ensure flexibility and adaptability. Policy Paper B explains how, after examining governance approaches in several other jurisdictions and industries, we arrived at the key elements of our proposed governance model: a public oversight body; a self-governing organization for the industry; and a transformed infrastructure entity, a reinvented Canadian Payments Association (CPA).

Policy Paper C: Legislation—Establishing the Payments Industry

The creation of a new governance model for the payments system will require legislation. Policy Paper C explains the existing legislation, which tends to be either institution-centred or focused on a specific problem. The Task Force proposes comprehensive and flexible legislation that would define the payments industry and its players, embody the guiding principles at the heart of the legislative framework and create the public oversight body. The public oversight body would, in turn, recognize a self-governing organization for the industry, which would represent the interests of payments system stakeholders. Membership would be mandatory for service providers and optional for users. The legislation would also reinvent the CPA as the provider of core infrastructure for the new system, as discussed in detail in the final paper.

Policy Paper D: Infrastructure—A Reinvented CPA

The final policy paper identifies the problems relating to the aging shared infrastructure on which much of the current payments system operates. It identifies new objectives for core infrastructure: access to networks for all players who meet transparent and objective minimum criteria, interoperability domestically

and with the payments systems of other countries, and support for the government's roles. The paper also explains that the Task Force is recommending that the reinvented CPA include the Interac/Acxsys system and cheque processing to create a unified low-cost platform for small payments.

Policy Paper D proposes to transform the payments infrastructure in such a way that it can, through innovation, grow to meet the evolving payments needs of Canadians in a digital economy.

To realize these objectives, the paper details legislative changes that would transform the CPA to enable it to play a full role in the future of Canada's payments infrastructure.

Responding to our mandate

Our work, as reflected in our final report and in the various papers outlined above, addresses the six specific challenges given in our mandate by the Minister of Finance. We did not attempt to address the Minister's questions one-by-one but rather looked for the answers to emerge from our work as a whole.

The following paragraphs summarize how our discussion and policy papers respond to the elements of our mandate. We start at the end of the Minister's list and work our way back, which is essentially how the logic of our conclusions flows.

- In the last of the Minister's questions, the Task Force was asked to "assess and report on whether consumers and merchants are well served by the domestic payments system." The simple and consistent answer is that those who use the current domestic payments system are not adequately served. Those who depend on the system include consumers, merchants, small and medium businesses, not-for-profit organizations, and large corporate and government users. We document what we heard from them in *Policy Paper A: Users*. Moreover, we found that, unless strong measures are taken, the gap between users' needs and expectations and what the system actually delivers is likely to grow and become increasingly detrimental to the country's economic health. These issues are explored further in several of the discussion papers, including *The Way We Pay*, *Going Digital* and *Credit and Debit Card Markets*.
- When we looked over our findings to "assess the degree of innovation in the domestic payments system and report on the challenges and opportunities to bring new and innovative products to market in Canada," we again found a discrepancy between the potential and what we are on track to achieve. As is documented in *Going Digital*, Canada is lagging in terms of innovation, in part because the various stakeholders have not worked proactively together. We found two major barriers to the new entrants who could bring innovation and competition: lack of access to core infrastructure and uncertainty about rules. Much of our dialogue with users and providers was aimed at understanding and addressing this problem, and we found significant opportunities to improve efficiency and offer beneficial new services to Canadians. How to make the system more innovative is addressed particularly by *Policy Paper B: Governance* and *Policy Paper D: Infrastructure*, as well as in the discussion paper *Going Digital*.
- Our efforts to "assess the competitive landscape by identifying any potential barriers for new entrants and mechanisms to improve the competitive landscape of the domestic payments system" quickly confirmed that Canada could be doing much better. While there is competition at the edges of the payments system, new entrants face regulatory uncertainty and significant hurdles in gaining

access to core infrastructure. This reality reflects both the ability of incumbents to maintain bottlenecks and the existence of gaps in government oversight. At the same time, the growing presence of new competitors, unregulated by the current legislative framework, points to possible regulatory inconsistencies that may needlessly increase risk. None of this is conducive to healthy competition and constructive development. Finding solutions to these problems will require action across the whole range of policy measures, as is suggested in *Policy Paper B: Governance*, *Policy Paper C: Legislation* and *Policy Paper D: Infrastructure*.

- When we came to “assess and report on the safety and soundness of the Canadian payments system,” the picture was much more positive. The Canadian payments system has an excellent overall record for its safety and soundness. The current regulatory framework, however, is not adequately geared to dealing with providers other than financial institutions, including many of the new entrants. Moreover, as shown in *Policy Paper A: Users*, the lack of coherence and consistency in the regulatory regime means that users get very little help from the industry when it comes to assessing risks or understanding their rights and obligations. A major theme of the papers is therefore how to ensure that regulatory requirements are sufficient to maintain safety and soundness but not so onerous that they stifle competition and innovation.
- The two items at the top of the mandate list form a pair: “identify public policy objectives to be pursued in the operation and regulation of the payments system” and “identify and assess the regulatory and institutional structures best suited to achieving these public policy objectives.” With respect to the first, we sought to define the desired objectives throughout our many dialogues. The input of users, notably consumers, was particularly helpful and was the main influence that led us to our very simple ultimate formulation of the necessary principles for the payments system as being *trust*, *access* and *good value*. Of course, we had to expand on this idea and explain what it meant in terms of the design features of a payments system, and we did this in the later parts of *Policy Paper A: Users*, *Policy Paper B: Governance* and *Policy Paper C: Legislation*. We leave to drafting experts the question of how best to embed these principles, and the objectives derived from them, in the legislative framework.
- When, finally, we sought to address the Minister’s request to “identify and assess the regulatory and institutional structures best suited to achieving these public policy objectives,” we concluded that the challenges of the payments system should be addressed to the greatest extent possible by the stakeholders themselves, through a self-governing structure that includes not only the payments industry but, crucially, its users. We also saw that there was a need to protect the public interest, not just during the establishment of a new governance model but as a permanent feature of it, and that this required a public oversight mechanism ultimately responsible to the Minister of Finance. These ideas are explored in two policy papers, B: Governance and C: Legislation. The need for a new approach to governing and managing core infrastructure in the public interest, one that will enable innovation in the Canadian payments system, is central to the discussion in *Policy Paper D: Infrastructure*. In addition, the discussion paper *Credit and Debit Card Markets* proposes specific changes in the way these important payment methods are overseen.

Thus, the discussion papers and policy papers offer insight into the evolution of the thinking of the Task Force and its advisory groups and provide a foundation for the advice offered in our final report.

Outcomes of the review: Final report

Based on its review, the Task Force, in its final report *Moving Canada into the Digital Age*, concluded that effective and responsive governance is essential to the success of a digital payments system in Canada. We observed that the emerging industry will be characterized by rapid and discontinuous change, making it essential that the payments system be able to adapt quickly and flexibly to new challenges and opportunities.

We concluded that the policy and governance underpinnings of the current payments system do not provide this capability. The existing infrastructure entity, the CPA, is governed by its members, the Canadian deposit-taking financial institutions, and its board is particularly influenced by the views of the major banks. The inherent conflicts of interest in this arrangement have made it difficult for the organization to plan and build for the longer term and provide little incentive for it to remove barriers to entry for new participants. As a result, Canada's payments system has been unresponsive to market forces and shows few signs of undertaking the fundamental innovation that will be required if it is to catch up with what is happening in many other countries.

The solution, we believe, lies in establishing a governance model that is collaborative, flexible and adaptable, and that also protects the public interest.

Technological change, new entrants and competitors, shifting risks and opportunities, and security and privacy issues all pose challenges that can be solved only when healthy collaboration is built into decision making. The Task Force envisions a governance model more inclusive than others around the world. This model would bring together the financial institutions, payment card networks, acquirers and new-entrant payments service providers—all the system participants who must help make and abide by new rules. It would also include users of the payments system who are affected by the rules: consumers, merchants, small and medium enterprises, not-for-profit organizations, as well as large corporations and governments.

Given how rapidly payments technology is shifting, governance will need to be eminently flexible and adaptable, offering industry—including businesses and innovators of all types and sizes—as much rulemaking authority as possible.

The complexity of Canada's emerging payments system virtually guarantees that the stakeholders tasked with governance will experience moments of impasse or indecision. Particularly at such times, protection of the public interest requires oversight by the public sector.

As a result of its extensive consultations with payments system participants and stakeholders, the Task Force has concluded that the principles of *trust*, *access* and *good value* must explicitly guide the governance of Canada's payments system.

The Task Force therefore calls on the Government of Canada to implement a principles-based governance model for Canada's payments system to ensure that the needs of users are met, to protect the public interest and to encourage collaboration and innovation by all stakeholders, now and in the future.

To achieve this, the Task Force proposes that the government introduce legislation to do the following:

1. **Define a discrete payments industry**, establish the basis on which its members would be recognized and establish the principles and objectives of the new governance model, including trust, access and good value.
2. **Create a new public oversight body for the Canadian payments system to protect the public interest**, broadly defined, through an approach based on the principles of *trust, access and good value*, and in so doing to:
 - i. Monitor the implementation of changes in the payments system, ensure that it continues to meet the public interest and propose or require adjustments where necessary;
 - ii. Provide guidance or resolution, where necessary, when the industry cannot agree on a solution; and
 - iii. Take action if private sector behaviour is no longer consistent with the public interest as determined by the legislation.
3. **Encourage the industry to create a broad-based and collaborative association to serve as the self-governing organization** that will develop and implement strategy and standards for the payments system, based on the following:
 - i. Mandatory membership for recognized participants in the payments industry, and
 - ii. Voluntary involvement for user groups (consumers, businesses and government) and other interested parties.

The intention is that, once appropriately established, this entity would be formally recognized by the public oversight body as the self-governing organization for the Canadian payments system, and that much of the authority of the public oversight body would be delegated to it, always subject to oversight and potential direction.

4. **Reinvent the objects, governance, powers and business model of the Canadian Payments Association** to enable it to provide core infrastructure that underpins an innovative payments system for the future and that is responsive to Canadians' needs while maintaining our trust and promoting accessibility and efficiency.

We also recommend that the government not wait for legislative change to be completed before initiating a process of change in this area of vital importance to the economy as well as to individual Canadians, businesses and governments. We therefore urge the government to call together the principal players to begin, without delay, planning and building for the future of the Canadian payments system. One issue in particular that deserves urgent attention is the proposal of the Task Force to begin building the much-needed unified low-cost platform for small payments by including the Interac/Acxsys system and cheque processing within the CPA core infrastructure.

Annex 1: Glossary of acronyms and abbreviations

(Items refer to the Canadian context unless otherwise specified.)

ABM – automated banking machine

ACH – Automated Clearing House (USA)

ACSS – Automated Clearing Settlement System

AML (or AML/ATF) legislation – *Proceeds of Crime (Money Laundering) and Terrorist Financing Act*

APCA – Australian Payments and Clearing Association

APF – Australia Payments Forum

ATM – automated teller machine

BACS – Bankers Automated Clearing Services (UK)

BEA – *Bills of Exchange Act*

CDCC – Canadian Derivatives Clearing Corporation

CDSX – a clearing and settlement system for securities operated by the Canadian Depository for Securities

CHAPS – Clearing House Automated Payment System (UK)

CHIPS – Clearing House Interbank Payments System (USA)

CLS Bank – CLS Bank International

CP Act – *Canadian Payments Act*

CPA – Canadian Payments Association

CPN – CPA Services Network

CPSS – Committee on Payment and Settlement Systems (of the Bank for International Settlements)

CSA – Canadian Securities Administrators

EIP – electronic invoicing and payments

EMT – electronic money transfer

EPC – European Payments Council

FCAC – Financial Consumer Agency of Canada

FDIC – Federal Deposit Insurance Corporation (USA)

IFT – immediate funds transfer

IIROC – Investment Industry Regulatory Organization of Canada

LVTS – Large Value Transfer System

MFDA – Mutual Fund Dealers Association of Canada

NACHA – The Electronics Payments Association (manages the ACH network) (USA)

NSS – National Settlement Service (USA)

ODFI – originating depository financial institution

ODP – online debt payment

OFT – Office of Fair Trading (UK)

OSC – Ontario Securities Commission

OSFI – Office of the Superintendent of Financial Institutions

PCNA – *Payment Card Networks Act*

PCSA – *Payment Clearing and Settlement Act*

PIPEDA – *Personal Information Protection and Electronic Documents Act*

POB – public oversight body

PSD – Payment Services Directive (EU)

SAC – Senior Advisory Committee (on federally regulated financial institutions)

SEPA – Single Euro Payments Area (EU)

SGO – self-governing organization

SMEs – small and medium enterprises

USBX – U.S. Dollar Bulk Exchange

Annex 2: List of major Task Force publications

Final report

Moving Canada into the Digital Age: A Report of the Task Force for the Payments System Review

Policy papers

Policy Papers: An Overview

Policy Paper A: Users and their Discontent

Policy Paper B: Governance—Stakeholders and their Disconnect

Policy Paper C: Legislation—Establishing the Payments Industry

Policy Paper D: Infrastructure—A Reinvented Canadian Payments Association

Discussion papers

On Dialogue: Our Discussion Papers

Scenarios for the Future of the Canadian Payments System

The Way We Pay: Transforming the Canadian Payments System

Going Digital: Transitioning to Digital Payments

Credit and Debit Card Markets